SUMMARY DESCRIPTION OF S. 639 AND S. 1099

RELATING TO

STATE TAXATION OF INTERSTATE SALES

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

of the

SENATE COMMITTEE ON FINANCE

on November 6, 1987

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

November 5, 1987

JCX-19-87

J862-41
S362-20

INTRODUCTION

The Subcommittee on Taxation and Debt Management of the Senate Committee on Finance has scheduled a public hearing on November 6, 1987, on S. 639 (introduced by Senator Burdick) and S. 1099 (introduced by Senator Cochran). The bills would eliminate certain restrictions on the powers of a State in taxing sales in interstate commerce.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary description of present law, S. 639 and S. 1099, and an overview of the issues raised by the bills.

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[1] This document may be cited as follows: Joint Committee on Taxation, Summary Description of S. 639 and S. 1099 Relating to State Taxation of Interstate Sales (JCX-19-87), November 5, 1987.

I. PRESENT LAW

Under the Constitution, a State or local government may impose taxes on sales that occur within its jurisdiction or on the use of property within its jurisdiction. (Approximately 6,700 State and local jurisdictions impose sales and use taxes.)[2] The allowable sales tax authority of a State or local government extends to mail order sales by out-of-State vendors to residents of the State if the sale is deemed to take place within the taxing jurisdiction.[3] There are, however, limitations on the methods State and local jurisdictions may employ to collect sales and use taxes.

State and local sales and use taxes are levied on the final purchaser, but are collected primarily through the vendor. In the case of a sale by an out-of-State vendor, the U.S. Supreme Court has held that the State or local government cannot constitutionally require the vendor to collect and remit use taxes unless the vendor has a sufficient business nexus with the State.[4] In the National Bellas Hess case, the Court found that the required nexus was not present where the vendor's only connection with customers in the State was by common carriers or the United States mail.[5] The Court based this conclusion on due process considerations and on the Commerce Clause of the United States Constitution, which reserves to Congress the power to regulate and control interstate commerce.[6] The required nexus has been held to exist where the vendor arranges sales through local agents or maintains retail stores in the taxing State.

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[2] Advisory Commission on Intergovernmental Relations, State and Local Taxation of Out-of-State Mail Order Sales (April 1986), p. 6.

[3] See, e.g., McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944).

[4] National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967) (henceforth referred to as National Bellas Hess).

[5] Id. at 754.

[6] Id. at 760.

II. DESCRIPTION OF PROPOSED LEGISLATION

S. 639--Senator Burdick

Under S. 639, any State (as well as the District of Columbia) or a political subdivision of a State could impose a sales or use tax on tangible personal property sold by a person outside the State and delivered by common carrier or the United States Postal Service to a purchaser within the State.

S. 1099--Senator Cochran

Under S. 1099, any State (as well as the District of Columbia) could require sellers to collect a sales tax on sales of tangible personal property to be delivered (by any means of delivery) to a destination within the State. The obligation to collect the sales tax would be limited to sellers that regularly or systematically solicit sales in the State and have annual gross receipts exceeding $12,500,000 from sales of tangible personal property throughout the United States or exceeding $500,000 from sales within that State.

The sales tax must be imposed by the State and be uniform throughout the State for the State to be permitted to require out-of-State sellers to collect these taxes. In addition, a seller's obligation to collect tax on sales of tangible personal property would extend to local sales taxes, provided that (1) all local jurisdictions in the State impose a sales tax at the same rate on identical transactions in tangible personal property, and (2) the local sales tax is collected and administered by the State.

The bill would provide that States could not require sellers to file sales tax returns, or remit the receipts of a sales tax, more frequently than once every three months. In addition, States could not require any person who collects a sales tax to make an accounting for the receipts of the tax on the basis of the geographical location at which the taxable transactions occur.

III. OVERVIEW OF ISSUES

The purpose of each bill is to minimize the disparity between in-State and out-of-State vendors that arises from the constitutional limitation on the power of a State or local government to require collection and remission of sales or use tax by out-of-State vendors with no sales agents or retail stores in the State. Because State and local governments rely on vendors to collect and remit sales and use taxes on State residents, this constitutional limitation on the collection of these taxes generally has prevented the effective imposition of sales and use taxes on mail order sales by these out-of-State vendors. Accordingly, to the extent that purchasers can avoid sales or use tax liability by making mail order purchases from these out-of-State vendors, these vendors realize a competitive advantage in relation to in-State vendors (as well as in relation to out-of-State vendors with sales agents or retail stores in the State).

The bills might not completely eliminate the disparity between in-State and out-of-State vendors, in that the bills only relate to the taxation of tangible personal property. The scope of the sales and use taxes of several States is broader than that, extending, for example, to certain services and advertising.

Some argue that disparity of sales tax treatment of in-State and out-of-State vendors is undesirable for two reasons. First, they argue that equal tax treatment of in-State and out-of-State businesses is preferable to providing one type of business with a competitive advantage based solely upon the nonpayment of State taxes. Second, they assert that State and local governments should be assisted in collecting all revenues to which they are entitled, particularly to the extent that their tax bases are affected by out-of-State mail order sales.

Others argue that Federal legislation should not be adopted addressing this issue even if the above arguments generally express the proper policy. They rely principally on two concerns--constitutionality and the administrative burden on vendors.

The constitutional issue arises under National Bellas Hess, in which the Supreme Court held that a State could not require an out-of-State mail order vendor with no local agents or local retail stores to collect and remit sales or use taxes with respect to its sales. Some observers note that because the mail order sales in National Bellas Hess were viewed as "exclusively interstate in character," the Supreme Court concluded that "this is a domain where Congress alone has the power of regulation and control."[7] Thus, these

observers argue that Federal legislation authorizing State and local governments to require collection and remission by out-of-State vendors of sales or use taxes would remove the constitutional defect that the Supreme Court found. Other observers respond by arguing that National Bellas Hess requires a significant nexus between the out-of-State vendor and the taxing jurisdiction and that, on due process grounds, Congress may not be able constitutionally to dispense with this nexus requirement.

The issue of administrative burden arises because a mail order vendor, in order to comply with a requirement that it collect and remit sales and use taxes, would have to be familiar with the tax laws in all jurisdictions with respect to which the requirement arose. In light of the multiplicity of sales tax rules applying in different political subdivisions of States, S. 1099 seeks to reduce this complexity by providing for the collection of local tax only if the rate of tax is equal for all geographic areas in the State.

In its 1986 report,[8] the Advisory Commission on Intergovernmental Relations (ACIR) recommended that Federal legislation be enacted generally similar in intent to both bills.

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7 Id. at 759-60.

8 See Note 2, above.